

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, CA 94105**

File No. RH04034833

Date: September 11, 2006

Regulations Re: Workers' Compensation Fraud

INITIAL STATEMENT OF REASONS

INTRODUCTION

The Insurance Commissioner hereby proposes to amend California Code of Regulations, Title 10, Chapter 5, subdivision 2698.52 (c), 2698.53(b) and 2698.56(c) so that these subdivisions are identical to the emergency regulations (presently in effect) found at Title 10, Chapter 5, Sections 2698.52 (c), 2698.53(b) and 2698.56(c).

STATEMENT OF THE PUBLIC PROBLEM

The costs of workers' compensation insurance fraud is astronomical and passed on to the insurance consumer directly through an increase in insurance premiums and indirectly when businesses increase the cost of goods and services to cover their own increased costs. To combat the problem of workers' compensation insurance fraud, the California Legislature enacted California Insurance Code Section 1872.83; this statute requires that the California Department of Insurance (Fraud Division) aggressively investigate probable workers' compensation insurance fraud and establish a grant program to compensate district attorneys who prosecute suspected fraudulent activities. In 1993, the Insurance Commissioner promulgated regulations to fully implement California Insurance Code Section 1872.83. These regulations set forth the criteria for distribution of funds to district attorneys for enhanced investigation and prosecution of workers' compensation insurance fraud cases and are set forth at California Code of Regulations, Title 10, Chapter 5, Sections 2698.50-59.

After a recent review of the operation of the grant program required by California Insurance Code Section 1872.83 the Commissioner determined Title 10, Chapter 5, subdivisions 2698.52 (c), 2698.53(b) and 2698.56(c) need to be amended as they undermine the efficiency of the grant program required by California Insurance Code Section 1872.83.

On March 3, 2006 the Office of Administrative Law approved emergency regulations that amend subdivisions 2698.52 (c), 2698.53(b) and 2698.56(c). These emergency regulations remain in effect until November 28, 2006.

The originally enacted subdivision 2698.52 (c) required the Department of Insurance to set aside (reserve) five percent of funds available for grants and distribute in January, following the regular annual grant award pursuant to 2698.53(b), the amount that had been set aside. The emergency regulation set forth at Title 10 of the California Code of Regulations, subdivision 2698.52(c), eliminates the 5% reserve requirement. This modification improves the program's efficiency by eliminating the requirements of a statewide publicly noticed meeting and the submission and review of reserve-grant applications. The statewide meeting created a significant expense for the Department. It was attended by approximately forty (40) participating assistant district attorneys from every geographic area of the state, approximately ten (10) Department of Insurance staff, and the Fraud Assessment Commission, a state advisory body created by California Insurance Code section 1872.83(b)(1). Moreover, the reserve requirement has become unnecessary as the majority of California counties currently participate as regular program grantees and thus the reserve no longer serves its intended purpose of attracting district attorneys to join the program to prosecute workers' compensation fraud.

The second proposed regulatory change (adopted as an emergency regulation on March 3, 2006) modifies Title 10 of the California Code of Regulations, subdivision 2698.53(b) by eliminating the semi-annual distribution of funds, specifically the January distribution date, and instead requiring one annual distribution of grant funds to eligible grantees.

The third proposed regulatory change (adopted as an emergency regulation on March 3, 2006) modifies Title 10 of the California Code of Regulations; subdivision 2698.56(c). The revision eliminates the Federal OMB Circular A-87 accounting methodology for district attorneys' indirect costs. The originally enacted subdivision 2698.56 authorized three (3) methodologies for determining district attorney indirect costs. The use of these various methodologies has created sizable disparities amongst district attorneys' reimbursement requests to cover similar size counties and workers' compensation anti-fraud programs. This inefficiency was seriously criticized by the Bureau of State Audits, which also recommended eliminating the A-87 option. Furthermore, the elimination of the Federal OMB Circular A-87 accounting methodology will standardize the allowable accounting methodologies amongst other anti-fraud grant programs.

(Amend) Section 2698.52 (c)

Section 2698.52(c) (as amended) provides that any district attorney who fails to submit an application or whose application is not received by the Insurance Commissioner at the address specified in the Request for Application by the deadline shall not be considered for funding. The final two sentences of the originally enacted regulation that required the Department to reserve five percent of funds for local programs to offset unanticipated costs of prosecution of cases have been deleted from this subdivision. This change is reasonably necessary to improve and further implement the grant process authorized by statute; it creates a more efficient process and eliminates an administrative burden (that of creating a maintaining a reserve fund) on the Department. Further, this revision to the text is necessary to clarify and specify the current requirements imposed on an applicant.

(Amend) Section 2698.53 (b)

The second proposed regulatory change modifies Title 10 of the California Code of Regulations, subdivision 2698.53(b) by eliminating the semi-annual distribution of funds, specifically the January distribution date, and instead requiring one annual distribution of grant funds to eligible grantees. This change is reasonably necessary to improve and further implement the grant process authorized by California Insurance Code Section 1872.83; the proposed modification creates a more efficient grant process and eliminates an administrative burden (that of creating a maintaining a reserve fund) on the Department. Further, this revision to text is necessary to clarify and specify the current procedures for the distribution of funds.

(Amend) 2698.56 (c)

The third proposed regulatory change affects Title 10 of the California Code of Regulations, subdivision 2698.56 (c) by eliminating the Federal OMB Circular A-87 accounting methodology for district attorneys' indirect costs. The originally enacted subdivision 2698.5 authorized three (3) methodologies for determining district attorney indirect costs. The multiple methodologies available to determine indirect costs have created sizable disparities amongst district attorneys' reimbursement requests to cover similar size counties and workers' compensation anti-fraud programs. This inefficiency was seriously criticized by the Bureau of State Audits, which also recommended eliminating the A-87 option. Furthermore, this change will standardize the allowable accounting methodologies amongst other anti-fraud grant programs.

This change is reasonably necessary to improve and further implement the grant process authorized by California Insurance Code Section 1872.83; the proposed modification creates a more efficient grant process and eliminates an administrative burden (that of creating a maintaining a reserve fund) on the Department. Further, this revision to text is necessary to clarify and specify the current procedures for the distribution of funds.

IDENTIFICATION OF STUDIES AND REPORTS

The Commissioner did not rely on any reports or studies in the development of the proposed regulations.

SPECIFIC TECHNOLOGIES OR EQUIPMENT

Adoption of the proposed regulations would not mandate the use of specific technologies or equipment.

CONSIDERATION OF ALTERNATIVES

The Commissioner has determined that no reasonable alternative exists to carry out the purpose for which the regulations are proposed.

IMPACT ON SMALL BUSINESSES

The Commissioner has preliminarily determined that these regulations will have no impact on small businesses.

PRE-NOTICE DISCUSSIONS

The Commissioner has engaged in extensive pre-notice discussions with both the Fraud Assessment Commission and district attorneys.